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SOCIAL CAPITAL, INSTITUTIONS AND TRUST

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Social capital, institutions and trust

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Abstract

This paper analyzes the relations between social capital, institutions and trust. These concepts are full of ambiguity and confusion. This paper attempts to dissolve some of the confusion, by distinguishing trust and control, and analyzing institutional and relational conditions of trust. It presents a tool for the analysis of the foundations of trust and a diagnosis of its strength and viability.

JEL code: D02, D63, D64, D71, L14, P16, Z13

Key words: social capital, institutions, trust, economic systems

Introduction

If social capital is associated with a set of largely informal relationships that may help the achievement of goals, how is it related to institutions and trust, which may also serve that purpose? Can social capital, institutions and trust substitute for each other, or are they complements, or preconditions for each other, or consequences of each other, or all of these? These are the questions for the present paper. Trust is both an outcome and an antecedent of relationships. It forms a basis for relationships, and thus generates social capital. It may be based on institutions, and it may be built from relationships, and then it arises from social capital.

Trust matters because of relational risk. Here risk is used in an ordinary language sense of being vulnerable to actions of others, and yielding a possibility of loss (Luhmann 1988, Chiles and McMackin 1996). It is not used here in the technical sense of risk, used in economics, as being amenable to calculus of probability for a known range of possible outcomes, as opposed to ‘real uncertainty’, where one does not know what may occur (Knight 1921). Some authors proposed that trust can be analyzed as a subjective probability concerning outcomes (Gambetta 1988, Dasgupta 1988, Mayer et al. 1995, Gulati 1995), but in my view possible future behaviour of people is subject to more radical uncertainty, due to interactions between people that shift conditions, perceptions and preferences, so that there is no pre-established range of identifiable possible outcomes (Nooteboom 2002). People may themselves be convinced that they will act in a trustworthy fashion until they meet with unforeseen temptations and pressures that impel them to break trust.

In the literature, trust is seen as both a type of behaviour (Deutsch 1962) and an underlying disposition (Bradach and Eccles 1989, Sako 1992, Das and Teng 2001). Deutsch (1962) defined trusting behaviour as consisting of actions that (1) increase one's vulnerability (2) to another whose behaviour is not under one's control (3) in a situation where the penalty one suffers if the other abuses that vulnerability is greater than the benefit one gains if the other does not abuse that vulnerability. Bradach and Eccles (1989: 104) defined trust as 'a type of expectation that alleviates the fear that one's exchange partner will act opportunistically'.

Trust has extrinsic, instrumental value in helping to reduce the risks and transaction costs of relationships. This is particularly important when risks are difficult or expensive to manage by formal means, such as government control, legal contract and hierarchy. Formal means of control can never completely eliminate relational risk, and hence some degree of trust is always needed. Trust may also be valued for its own, intrinsic value (Blau 1964, Arrow 1974, Jarillo 1988, Buckley and Casson 1988, Bradach & Eccles 1989, Powell 1990, Casson 1991, 1995, Helper 1990, Sako 1992, Gulati 1995, Berger, Noorderhaven & Nooteboom 1995, Chiles & MacMackin 1996, Nooteboom 1996). While trust may be built within relationships, on a personal basis, it may also arise outside relationships, more impersonally, on the basis of institutions (Deutsch 1973, Shapiro 1987, Bachmann 2000, Nooteboom 2002), and it may be facilitated by intermediaries or go-betweens (Shapiro 1987, Nooteboom 2002).

Countries vary in the extent that there are institutions that support trust, and to the extent that there are no such institutions, trust must be built entirely from relationships, and without institutional support that can be laborious and such trust can be fragile. For institutions to form a basis for trust in people (institution based trust), one must have trust in those institutions (institutional trust). This paper will analyze the institutional foundations of trust in some detail.

The development of industrial societies can be seen as a movement away from highly personalized trust relationships, in small and tight, localized communities, in which people are involved with most of their personality, largely excluding membership of other groups, towards larger, more varied groups, with more abstract, depersonalized relationships, in each of which people are involved only with a limited part of their personality (Simmel 1950). Closed, small, homogeneous groups that engage individuals more fully, are cohesive but also yield isolation, which obstructs sophisticated division of labour and innovation. As Simmel (1950: 218) noted, similarity reassures, but contrast stimulates. In developed industrial societies, people are members of a greater diversity of groups, with limited involvement in each, and reliance is based to a much lesser extent on personal trust, and more on institutional conditions of laws and law enforcement, intermediaries of many kinds, and complex patterns of mutual dependence. Large groups of people, with large markets, allow for efficiency by division of labour, but also require it for the sake of governance.

A possible dilemma for developing countries now is the following. For them, perhaps more than in developed countries, there is a need for social capital, to achieve efficiency, in division of labour, and innovation by novel combinations, but in developing countries the basis for social capital may largely lie in personalized trust, which, when not combined with other bases for trust, may lock people into closed, localized, cohesive communities that keep them from opening up to wider perspectives of development, from

efficiency and innovation, in wider, more dispersed groups. Then, it may be of some interest to analyze in more detail the institutions that may support personal trust and widen the basis for trust.

The article proceeds as follows. First, it reviews features of social capital. Second, it reviews some of the fundamentals of trust, and identifies and tries to resolve misunderstandings and ambiguities. Third, it presents a tool for the analysis of the sources of trustworthiness, including both institutional and more personalized sources. Fourth, it looks at more detail at the relationship between social capital and trust.

Social capital

The term ‘social capital’ is used very broadly. So broadly, indeed, as to often cause confusion what is meant in specific uses of the term (Knorringa and van Staveren 2005). For a recent survey of definitions of social capital that illustrates this, see Knowles (2005). Social capital seems to denote almost anything related to ties between people. It denotes a stock of ties, features of such ties, conditions for their functioning and their outcomes. It includes formal or informal groups of many kinds, and connections between such groups. Its possible features include the composition, structure, content and type of ties, strength of ties, and trust, rules, shared norms of conduct, or values underlying such norms. The conditions for its existence include formal and informal institutions and trust.

Here, I aim not for essentialist definitions that tell us what social capital, institutions and trust ‘really are’, but for pragmatic definitions, which accord, as much as possible, with established meanings, but also clarify them, and are fruitful for explaining phenomena. Let me start with a definition of institutions, as rules or habits that condition, i.e. enable and constrain, action, apply universally to a group of people, have normative content or import, and carry sanctions for non-compliance, including non-material sanctions such as loss of legitimacy. In addition to obvious things such as legal systems, established meanings, and the intersubjective order of language more generally, also form an institution. This intersubjective order of language, called ‘langue’ by de Saussure (1972) stands in contrast with idiosyncratic, creative language use, called ‘parole’ by Saussure. In social interaction, linguistic order is imposed, constraining parole, but in due course it may also be shifted by it. This is the social capital of language.

I propose to define social capital as contributing to goal achievement of actors on the basis of relationships. Here, actors may be individual people, but also groups, such as firms or other organizations. In the latter case the relevant relationships are those between, not within the group. Of course, within the group one also has social capital, in relationships between people, but then the relevant actors are the members of the group, not the group as a whole. Like capital more generally, social capital requires investment to build.

Social capital differs from institutions, but is partly based on them, and may contribute to their development. In contrast with institutions, social capital is not pre-established and available to all, is directed towards goals of particular actors, and is costly to build. Usually, social capital is taken to refer to non-governmental and voluntary micro-level relationships, between people or organizations. They are not imposed by government but governmental organizations, such as municipalities or government-sponsored agencies

for the establishment and control of standards, regional development, knowledge transfer, subsidies, and the like, may play a role (Shapiro 1987). Also, social capital usually refers to informal rather than formal ties, such as hierarchical or contractual ties.

However, formal and informal ties often go together. For example, legal contracts and personal trust may replace but may also complement each other (Möllering 2005, Klein Woolthuis et al. 2005). The question then is how social capital, trust and institutions are related.

As extensively studied in the literature on social networks, the structure of relationships has several features, such as, among others, the number and composition of a network, in terms of origins, characteristics and roles of members, density (extent to which agents are directly connected), and ‘centrality’ of different kinds, e.g. the degree to which some agents have more direct ties than others do (‘degree centrality’), or lie more on crossroads of connections (betweenness centrality). These have important implications for trust and trustworthiness (Coleman 1988). The composition of ties includes the condition whether members have similar characteristics, such as activities and interests (as in the ‘bonding capital’ identified by Putnam 2000) or different ones (as in Putnam’s ‘bridging capital’). Networks may include intermediaries or go-betweens. Strength of ties also has several features (Granovetter 1973), such as type and scope of the content of ties (what the ties are about), duration, frequency of interaction, cognitive distance, investment in the relationship, trust and personal bonding (Gilsing and Nooteboom 2005).

Social capital is like ‘ordinary’ physical or financial capital in the sense that it requires investment, in the sense of sacrifice and effort, to build up and when not maintained may deteriorate in time. Like physical capital social capital is both the result of investment and a cause of economic performance (Gabbay and Leenders 2001). Like resources in general, it is not social capital itself but the services that it can render that may yield advantage (Penrose 1959). Social capital needs agency to have an effect (Van Staveren 2003). Like other capital, social capital may lay idle, or may be underutilized, and may be misused.

However, social capital is also unlike ‘ordinary capital’, in several respects. While it requires ‘investment’ in the sense of effort and sacrifice, trust as a feature of social capital cannot be bought and installed. If not already present, it needs to develop in time. Unlike ordinary capital, social capital may increase rather than wear out in its use. Using relationships often strengthens them. Unlike physical capital, social capital is not an individual but a shared property and it is inalienable (Van Staveren 2003), and it is not a rival good (it can be shared without diminishment).

Social capital is supposed to be beneficial, in furthering the achievement of goals (Gabbay and Leenders 1999) by connecting people in a fruitful and efficient manner. The goals that may be furthered (or not) by social capital can be various. They can be economic goals, such as short-term profit, long-term profit, employment or self-employment. They can be intermediate goals, as means to ends, such as division of labour, access to markets, reputation and innovation. Goals can also be non-economic (cf. Knorringa & van Staveren 2005), such as safety, uncertainty reduction, social acceptance and legitimation, and power. Goals of different participants in a group may be partly or wholly conflicting. While social capital may have the intended effect of contributing to goals, they may have unforeseen, unintended effects that frustrate goal achievement. For

example, social capital may yield relationships that are so close as to yield rigidities that obstruct innovation. While goal achievement is positive for those who have those goals, it can be highly detrimental for others, who may become victims. The mafia employs social capital (Pagden 1988) to its advantage and to the disaster of others. In sum, social capital may have a ‘dark side’ (Gargiulo and Benassi 1999), may have adverse effects (van Staveren 2003), and may become a ‘social liability’ (Gabbay and Leenders 2001),

The potential of relationships may lie in sheer numbers of association, to achieve economies of scale or scope, or political clout, or in complementary resources or competencies. For innovation, for example, different people, and different organizations, have different knowledge on the basis of different experience, yielding ‘cognitive distance’ between them (Nooteboom 1999). Such distance is both a problem, for mutual understanding and agreement, and an opportunity, for learning. Here, the challenge is to find optimal cognitive distance, small enough to allow for understanding and collaboration, and large enough to generate novelty (Wuyts et al. 2005, Nooteboom et al. 2005). If, as proposed by Schumpeter, innovation arises from ‘novel combinations’, the variety of knowledge between different (individual or corporate) agents is required for innovation. Here lies part of the significance of ‘bridging capital’ (Putnam 2000).

Relationships entail a certain duration, in contrast with ad hoc transactions. Investments and time are needed to build up relationships and to utilize their potential. Investments are needed to develop mutual understanding, trust, agreement and procedures for coordination and, possibly, for conflict resolution. Those investments are often at least partly relation-specific, in the technical sense of transaction cost economics (TCE, Williamson 1975, 1985, 1991, 1993, 1996) that they lose much or all of their value when the relationship breaks. As a result, they require a sufficient duration of the relationship to recoup the investment, and this creates a risk of dependence, or ‘hold-up’, as argued by TCE. Thus, social capital can yield benefits but also risks of dependence, and when dependence is strong and asymmetric, relationships can become repressive. Third parties may aid to achieve collaboration, in intermediation or arbitration, but may also use their position for manipulation or extortion, as a *tertius gaudens* (Simmel 1950, Burt 1992). In view of both possible positive outcomes and possible negative ones, in relational risk, both must be included in the analysis of social capital (Nooteboom 2004).

Social capital can be used to limit competition by dividing the market or fixing prices, in cartels, by raising entry barriers, as in guilds, professional associations and sometimes in trade organizations (cf. van Staveren 2003). This is the dark side of especially bonding capital. As argued in the network literature, while strong ties may be needed for learning (Hansen 1999, Gilsing and Nooteboom 2005), too strong ties may inhibit learning and innovation (Granovetter 1973, Burt 1992). Trust and social cohesion can be so tight as to prevent the ending of relationships when they deteriorate into adverse effects. A long duration of ties may reduce cognitive distance and the relationship may run out of innovative steam (Wuyts et al. 2005).¹

Trust matters, in particular, in view of the negative side of social capital. But what, more precisely, is trust?

¹ Long duration of tie does not always reduce cognitive distance, e.g. when both sides tap into other, non-overlapping outside connections, i.e. when the tie bridges a structural hole.

Basic features of trust

There are several misunderstandings and ambiguities surrounding the notion of trust, and to dissolve them it may be useful to unravel the concept in some detail. According to Nooteboom (2002), trust should be taken as a four-place predicate: the trustor (1) trusts a trustee (2, cf. Hardin 2002) in on or more aspects of behaviour (3), under certain circumstances (4). Trustees can be individual people, but also collectives, such as organizations, and institutions. The relation between trust in people and trust in organizations depends on the positions and roles that people have in an organization (Ring and van de Ven 1994) and on the organization's mode of coordinating behaviour.

Concerning aspects of behaviour that one may trust, it is customary to distinguish trust in competence (ability to conform to expectations) and trust in intentions (to perform in good faith according to the best of competence). Competence includes technical and cognitive competence. Trust in intentions of the trustee requires his commitment, i.e. attention to possible mishaps, and absence of opportunism. In the literature, absence of opportunism has been called 'benevolence', 'goodwill' and 'solidarity'.

This variety of aspects of behaviour one can have trust in raises problems concerning the measurement of trust, as in the World Values Survey (Inglehart 1994), used in an international comparison by Knack and Keefer (1997), on the basis of the survey question 'Generally speaking, would you say that most people can be trusted or that you cannot be too careful in dealing with people?' Knorringa and van Staveren (2005: 102) noted that people find it difficult to answer the question: 'Respondents in our survey found this by far the most difficult question to answer, and many respondents made clear they could not answer such a question in general, but that it depends on the type of other person'.

That is understandable from the present analysis. While it may seem clear that most people will interpret the question as referring to intentional rather than competence trust, we cannot be sure. It may well be that when people say that others cannot be trusted they mean that they cannot be expected to be trustworthy for sheer lack of ability or opportunity, regardless of intentions. If in the survey trust is indeed interpreted as intentional trust, is it taken to refer only to limited opportunism (benevolence) or, beyond that, also to care and commitment?

The dependence of trust on circumstances entails that trust is limited: one may trust someone (in competence or intentions) in some conditions but not in others that go beyond competence or beyond resistance to temptations or pressures of survival. When something goes wrong in a relationship, i.e. when expectations are disappointed, there is a problem of causal ambiguity. Broken expectations may be due to a mishap, a shortfall of competence, lack of commitment and attention, or opportunism, and it is often unclear what cause is at play. Opportunistic partners will claim accidents. When people are overly suspicious, from lack of self-confidence or adverse experience, in general or with a specific partner, they may jump to the conclusion of opportunism where in fact only a mishap occurred. The limits of trust will later be considered in more detail.

This point yields a second problem in the measurement of trust. If trust is an assessment of trustworthiness, and trustworthiness is subject to contingencies of survival, the assessment may be taken relative to those limits, which may vary between countries or other contexts of action. In other words, people may not be trusted because they are forced to cheat for sheer survival, regardless of inclinations or preferences to be

trustworthy. So while trust is taken as an antecedent of prosperity, real causality may be in reverse: prosperity enables people to be trustworthy.

Trust has psychological causes that impel feelings without reasoning, and rational reasons.² Psychological causes include emotions and may entail reflexes or automatic response. Rational reasons entail inference, on the basis of perceived behaviour, of someone's trustworthiness. Admittedly, rational reasons and emotional causes go together, as argued, in the context of trust, by Simmel (1950; see also Möllering 2001). Assessment of someone's trustworthiness, on the basis of observed or reported behaviour, is limited by uncertainty and bounded rationality. According to social psychology, it is mediated by mental heuristics, in perception and attribution of motives and competences of people, which are to some extent emotion-laden (Tversky and Kahneman 1983, Bazerman 1998, Smith and Mackie 2000). Using such heuristics, people infer, on the basis of 'relational signals', whether people are in a 'mental frame' conducive or detrimental to trustworthiness (Six 2005). Nevertheless, the distinction between reasons and causes is useful for analytical reasons, and judgments of trustworthiness can be more or less rational, in efforts to avoid 'jumping to conclusions', to be reasonable, and to extend benefit of the doubt to people when trouble occurs. Such benefit of the doubt is needed, in view of causal ambiguity: disappointments may not be due to opportunism.

Several authors have recognized that trust goes beyond control or 'deterrence' (Maguire et. al. 2001), in 'goodwill' or 'benevolence' (see e.g. the special issue of *Organization Studies* on 'Trust and control in organizational relations', 22/2, 2001). As noted by Maguire et. al. (2001: 286), if we do not include the latter, we conflate trust and power. Control or deterrence is part of calculative self-interest, but benevolence is not. Many authors feel that control is foreign to the notion of trust, and that 'genuine' trust is based on other, more social and personal foundations of trustworthiness. One can define trust broadly, as the expectation that a partner will not engage in opportunistic behaviour, for whatever reason, including control of his conduct. One can also define trust more narrowly, as the expectation that a partner will not engage in opportunistic behaviour, even in the face of short-term opportunities and incentives, in the absence of control (Bradach and Eccles 1984, Chiles and McMackin 1996).

To avoid confusion, and this is an important step for the further analysis in this paper, following Nooteboom (2002) I use the term 'reliance' to include both control and benevolence, and I use 'trust' for motives that go beyond control and self-interest. In other words, reliance may be based entirely on control, or on trust, or on combinations of the two. I will argue that reliance is always part of social capital, but trust may not be. That is, social capital may yield only control.

This yields a third problem in the measurement of trust. If, when asked about trust in a survey, people take it to refer to reliance, their answer will include an assessment of the force and effectiveness by which behaviour is controlled by laws and other regulations, and by economic incentives. Here, developing countries, with less developed formal institutions, are generally at a disadvantage, and the conclusion will tend to be that there

² Modern cognitive research (e.g. Damasio 2003) indicates that often what we see as reasons are in fact the result of feelings, and the reasons come afterward, as rationalizations. However, it still makes sense to make the analytical distinction between causes and reasons here, to indicate whether trust is impulsive or based on inference, even if the latter were an ex-post rationalization.

‘trust’ is less. If, on the other hand, trust is taken to refer to trust in the more specific sense of going beyond control, in the view that people will behave adequately in the absence of control, on the basis of ethical norms or personal bonds, it is conceivable that developing nations have more trust, if only because in the absence of institutions they need to. Unless, of course, conditions are so dire that for the sake of personal survival no one can afford to renounce any opportunity of gain, regardless of consequences to others, even within families, perhaps. Matters get even more confused when in a cross-national survey in some countries trust is interpreted as reliance and in others as trust going beyond control.

While trust can go beyond calculative self-interest, in benevolence, it does, and generally should, have its limits, as noted earlier. Blind, unconditional trust is generally unwise. Even benevolent people need to guard their self-interest, and it is not excessively cynical to assume that resistance to temptations to opportunism or betrayal is limited. It should be expected that people may cheat under pressures of survival. Managers may be expected to cheat to the extent that their firm is under pressure of survival in competition. An illustration is the ENRON affair. When the overriding survival criterion of a firm is short-term (quarterly) profit, and an economic slump erodes it, the firm leadership may feel irresistible pressure to cheat on the figures. A monopolist may be under less pressure, and can afford to give and take more than a firm under intense price competition (for an example, see Nooteboom 2002). Thus, one should maintain awareness of conditions where trustworthiness may be put under too large a strain.

In conclusion, while trust goes beyond control, and more trust allows for less control, so that trust and control are to some extent substitutes, they also complement each other (see also Möllering 2001) because trust has its limits. In a longitudinal study of the development of collaboration in innovation projects of small firms, Klein Woolthuis et al. (2005) found that trust and control are both substitutes and complements. More trust does indeed allow for less control, but often trust and contract go together, because where contract ends trust must begin, and since trust has its limits, contracts are seldom left out. The process of contracting can be costly and ex ante trust may then be needed to accept and incur that cost. Ex ante trust may be needed to generate the openness needed for an effective contract. Contracts may be needed for reasons of competence rather than intentions, as a technical device of coordination, to clarify distribution of tasks, set the requisite standards, and to prevent misunderstandings. Thus, extensive contracts need not indicate mistrust.

Sources of reliability

Nooteboom (2002) attempted to give a systematic analysis of sources (causes, reasons) why people may or may not be reliable, focusing on intentional reliability, in particular why people might not act opportunistically. An overview of sources of intentional reliability is given in Table 1. Perhaps this table can be used for an analysis of what foundations of trustworthiness may be lacking in developing countries, and what the implications and possible remedies for such lack might be.

Table 1 about here

In Table 1, a distinction is made between ‘micro’ foundations that are specific to a relationship (right hand column in Table 1), ‘macro’, institution-based foundations on the level of a wider community, such as a nation, region, industry or clan (left hand column), and ‘meso’ foundations that lie in the more direct social environment of actors, such as third parties, go-betweens or networks (middle column). The distinction between macro and micro sources is also known as the distinction between ‘universalistic’ or ‘generalized’ sources versus ‘particularistic’ sources, made by Deutsch (1973: 55), and between impersonal and personalized sources made by Shapiro (1987) and goes back to the work of Parsons. Now social capital mostly resides in between macro and micro, i.e. between institutional and relationship-internal sources, on a ‘meso’ level, yielding roles for ‘go-betweens’ (Nooteboom 2002), ‘guardians of trust’ (Shapiro 1987), ‘intermediate communities’ (Fukuyama 1995), ‘bridging groups’ (Putnam 2000, Knorringa and van Staveren 2005), or ‘bonding groups’ (Putnam 2000), to build reliability and reliance. The roles of go-betweens will be elaborated later, in a discussion of the process by which reliance is built. Table 1 will help to unravel how social capital, on the basis of intermediaries, may substitute for institutional sources and may support relationship-internal sources. This is indicated, in Table 1, with lines linking intermediaries with the various sources of reliability.

A distinction is also made between self-interested foundations (upper row in Table 1) and foundations that go beyond calculative self-interest (lower row). In self-interested foundations, trustworthiness may be based on control or deterrence. The trustor may control opportunities for opportunism (‘opportunity control’), or material incentives (‘incentive control’). On the macro, institutional level, opportunity control may be based on legal coercion. On the meso level, there is incentive control by reputation. There, one behaves well because bad behaviour would get known in relevant communities, whereby one would forego possibly profitable options for future relationships. On the micro, relation-specific level, opportunity control may be based on hierarchical control, or on incentive control by balance of dependence or hostages. In economic relations, hostages may take the form of staff stationed at each others’ firms, linkages by marriage, minority shareholding (the implicit threat being that one could sell the shares for take-over bids), but mostly commercially sensitive information (the implicit threat being that it may be divulged).

Beyond self-interest, and beyond control by the trustor, trustworthiness may be based on socially inculcated values, norms and customs (‘macro’), or on personal feelings of empathy or identification, or routinization of conduct in a relationship (‘micro’). Social norms may be a feature of a larger community, such as a nation, or of smaller ones, such as religious groups, tribes, clans, (extended) families, professional or trade organizations, organizations of the state or of business, or networks. Within a relationship, empathy entails the ability to understand another’s ‘way of thinking’, without sharing it (having mental models of other people’s mental models), and identification entails that one ‘thinks the same way’ (having similar mental models). For trust, one needs empathy, but not necessarily identification. One needs to understand ‘what makes others tick’, without necessarily ‘ticking in the same way’. Empathy is needed to have a sense of the limits of

trustworthiness, depending on circumstances, and to be able to imagine what it would be like to stand in another's shoes, in a process of reciprocity.

Concerning routinization of a relationship (lower right of Table 1), Herbert Simon a long time ago showed that routines have survival value due to bounded rationality, in the sense of bounded capacity for reflective thought. Routines allow us to reserve our scarce capacity of 'focal awareness' (Polanyi 1962), in rational, calculative thought, for conditions that are new and demand priority. When things go well for a while in a relationship, one tends to take at least some of it for granted. One may no longer think of opportunities for opportunism open to a partner, or to oneself. On the basis of experience in the relationship, trustworthiness is assumed until evidence to the contrary emerges. In other words, trust is a 'default'. The possibility of opportunism is relegated to 'subsidiary awareness' (Polanyi 1962). Generally, when something out of the ordinary occurs, our awareness shifts from subsidiary to 'focal' and we look critically at what is going on. As Simon (1983) pointed out, we need emotions of danger and excitement to catapult danger or opportunity into focal awareness. Next, in case of trouble we must control emotions to give the partner the benefit of the doubt, allowing for mishaps, rather than immediately assume the worst (opportunism). In this way, routine behaviour is not necessarily blind, or more accurately: it is not unconditional. Yet, as noted before, within limits trust can become routinized and be taken for granted. One does not continually scrutinize behaviour and conditions for opportunities for opportunism, for oneself or one's partner, until they are felt to be excessive. As noted before, in view of uncertainties concerning motives and conditions, trust can only operate as a default: one assumes trustworthiness, within boundaries, until evidence of its failure becomes manifest, and then one adjusts the limits of trust. In other words: one must trust to learn even about trustworthiness. If one only trusted under certainty one would never trust, thereby robbing oneself of the opportunity to learn about trustworthiness and its limits.

Routinization may also arise in the conformance to social norms that belong to the institutional environment (lower left of Table 1). A rule that is formal, in the sense that it is codified and documented, can become informal in the sense that it is internalized, in routinized conduct, becoming part of tacit knowledge, in subsidiary awareness. What once was a law may later become a custom. Thus, in time there may be a shift from formal to informal institutions, from the top left to the lower left in Table 1. The movement may also be vice versa. What once was taken for granted as a custom may later be formalized in a codified rule or law.

Some of those roles of go-betweens facilitate control and others facilitate trust building. That is why in the table go-betweens are located in between self-interested and altruistic sources.

The sources of reliability in the top half of Table 1 are extrinsic, i.e. people do not cheat because of penalties and rewards. In the lower half, motives are largely intrinsic, i.e. people do not cheat because they attach moral or emotional, personal value to reciprocity and loyalty. Frey (2002) indicated the risk that extrinsic motives crowd out intrinsic ones. If at first people behave adequately because they think it is right, and then they get financially rewarded for it, or punished for inadequate behaviour, they may feel justified to cheat because now they are paying for the right to cheat. A famous example is that of parents coming late to pick up their children from day care. When a fine was instituted, late collection increased because people now felt they were paying for it, while

before most people tried to collect their children in time out of solidarity with the staff. This is to be kept in mind in any attempt at 'institutional design' to further trust. However, in spite of this possible substitution between intrinsic and extrinsic motives, they need to exclude each other, and are often also complements, in the same way, and for similar reasons, that trust and control can be complementary.

The sources of reliability are not always used for the good, and may be used as instruments of the bad. The mafia (Sicily) and camorra (Naples) employ all sources to discipline their members: formal rules ('soldiers') and contracts, high material incentives and threats of harsh physical punishment, direct hierarchical supervision, mutual dependence, use of family members as hostages, marriages between families, an ethic of 'family' (the 'godfather', 'sons', 'brothers') and no outside betrayal ('omerta'), and a great deal of personal empathy, identification, friendship, and routinization.

The analysis on the basis of Table 1 is theoretical. For an example of how the analysis can be applied for empirical research of trust, see Nooteboom et al. (1997). In an econometric model of relationships between buyers and suppliers, intentional reliance as a dependent variable was operationalized as perceived risk of defection, with two variables: perceived size of possible loss due to opportunism, and probability that such loss would occur, measured on the basis of Likert scales. Explanatory variables, again measured with Likert scales, pertained to value of the partner as well as own value to the partner (to allow for mutual dependence as a factor of control), switching costs (as another determinant of dependence), and trust related variables concerning shared values and routinization. The outcome was that the trust related variables had a significant mitigating effect on perceived risk, next to variables associated with control.

An example of a practical application is the analysis of the sources of trust and reliance that citizens have in the Dutch police (Nooteboom 2006).

The trust process

Trust and reliance develop or break down, e.g. in finding out how far trustworthiness goes, in different aspects of behaviour. How far does someone's (or a firm's) competence go? Where are the weak spots? How robust is competence under adverse conditions? How strong are pressures of competition, and what slack of resources does a firm have under adversity, before it succumbs to temptation or pressure of survival? An important notion here, in the process of trust, is that of 'voice' (Hirschman 1970), in which one voices complaints concerning a relationship, with the intention to 'work things out' (Helper 1990), in 'give and take', as opposed to 'exit', where one opts out when dissatisfied. Voice is crucial for trust. This connects with the finding that openness is crucial for trust (Zand 1972). Trust is not an idyllic condition of being nice to each other. Six (2005) found that conflict does not necessarily lead to a breakdown of trust. When trouble is resolved by voice, it tends to deepen trust. Indeed, trust forms a basis for open disagreement where lack of trust would keep people aloof.

According to McAllister (1995) and Lewicki and Bunker (1996), there are several stages in the development of trust. When people have no prior experience with each other, and there is no information from reputation, risky relationships start on the basis of control, to achieve reliance, and then develop into trust, with the growth of empathy and next, perhaps, identification. However, beginnings set the atmosphere of a relationship

that may be difficult to turn around (Deutsch 1973), and a start by means of control may pin the relationship down in an atmosphere of distrust, where it may be difficult to develop trust. Shapiro (1987: 625) proposed that: 'Typically social exchange relations evolve in a slow process, starting with minor transactions in which little trust is required because little risk is involved and in which partners can prove their trustworthiness, enabling them to expand their relation and engage in major transactions'. This was later repeated by others (e.g. Ring and van de Ven 1992).

Nooteboom (2002) analyzed the role of decision heuristics from social psychology, in the building and the breakdown of trust. Six (2005) went into more detail of the trust process, in terms of mental frames of trust and mistrust that are triggered by relational signals, and identified a range of trust building actions. Six and Nooteboom (2005) hypothesized a taxonomy of such trust building actions that was largely confirmed in an international survey among managers.

For control, go-betweens can act as arbitrators or intermediaries, the difference being that for the first their ruling is binding and for the latter it is not. They can also help to balance mutual dependence, act as hostage keepers, help to control the flow of information, and institute a reputation mechanism by separating libel from legitimate complaints, and broadcasting bad conduct. For trust building, they can help to disambiguate causality in the interpretation of events, separating mishaps, lack of competence and opportunism. They can also help in the process of trust building, in a sequence of steps that fits the situation.

Such roles of go-betweens can be played by a host of governmental and non-governmental organizations, such as municipalities, local development agencies, agencies for the transfer of knowledge, standards agencies, professional or trade organizations, banks, legal firms, and consultants of many kinds. However, go-betweens are subject to temptations of opportunism and corruption, in favoring one side at a price, and may need to be monitored by higher level institutions (Shapiro 1987). The same, whole apparatus applies to the reliability of go-betweens: legal regulation, direct control by higher level institutions, a reputation mechanism, professional associations, a professional ethic, and relation-specific measures of dependence, hostage taking, or empathy.

Social capital, trust and institutions

My proposal now is to define social capital as a source of reliance intermediate between institutions (macro) and relationship-internal features (micro), as illustrated in Table 1. Perhaps this helps to make the concept of social capital less expansive and vague, and more determinate, and to clarify its difference with and its relation to institutions, trust and what happens within relationships. Recall that social capital lies in voluntary and informal intermediaries, i.e. not externally imposed and not supported by formal authority and official sanctions, which would make them part of institutions.

Intermediaries may substitute for institutions, thus possibly compensating for institutional weaknesses, and they may support or foster relationship-internal sources of reliability. This is illustrated in Table 1 by the lines connecting intermediaries with the different sources of reliability. Social capital may compensate for institutional weakness, e.g. by supporting a reputation mechanism instead of contractual control, when the legal

basis for the latter is insufficient. This may be important, in particular, in developing countries with less developed institutions, which would explain why social capital is particularly relevant in such countries.

One implication of this view is that social capital is a relative concept: relative to the relationships studied. In relationships between organizations social capital mostly lies in intermediary organizations. In relationships between people within an organization it mostly lies in other individuals, who perform (voluntary, informal) intermediary services within the organization. Between nations it can lie in informal supranational organizations, such as a variety of non-governmental agencies.

If one accepts the definition of reliance as including control, and trust as going beyond control, then social capital entails reliance but does not necessarily include trust in the intentional sense. Social capital may only support control, on the basis of reputation, monitoring, maintenance of standards, arbitration in conflicts, the formation of coalitions to constrain deviant behaviour, the development and maintenance of a balance of mutual dependence, or the keeping of hostages. Social capital may support repression and terror, as in the case of the mafia. Indirectly, of course it then does include trust in the sense that the parties involved should trust the intermediaries, at least in the competence sense, but there is not necessarily intentional trust between the protagonists.

However, social capital often does enhance and build intentional trust, and that may be its most important function. It can do so by furthering shared norms and values of conduct that go beyond established institutions, i.e. are more specific and tailored to specific relationships or actors. It can help in the process of building trust within relationships, by furthering the development of empathy and identification, by eliminating misunderstanding, prejudice or lack of self-confidence that generate mistrust without good reason. Recall that misunderstanding can easily arise due to the causal ambiguity involved in the disappointment of expectations. From the perspective of relational signaling, indicated earlier, according to which people attribute (un)trustworthiness to others on the basis of an interpretation of their observed behaviour, as relational signals, intermediaries may help by indicating the signaling effects of behaviour to the trustee, and by influencing the process by which they yield attribution by the trustor. While social capital may enhance control and trust, the two are not exclusive. Trust and control may both substitute and complement each other (Klein Woolthuis et al. 2005). This is related to Hirschman's (1970) notion of 'voice and exit'. When voice fails, people fall back on exit, and this option 'lurks in the background'.

The working of social capital, in the services of intermediaries, is enabled or constrained by a variety of factors. For example, it is affected by the structure and density of ties, as proposed in the social network literature. As argued by Coleman (1988), and earlier by Simmel (1950), dense network enhances reputation mechanisms and coalition formation

Conclusions

First of all, the analysis has implications for the measurement of trust in any future study of trust and development. First, it should be clear what the object of trust is: institutions, organizations, or individuals, and which ones. Second, a distinction should be made, in

the design of survey questions, between trust in competence and trust in intentions, with, in the latter, a distinction between opportunism and lack of commitment. Third, one should be aware that trust always has its limits, so the question is not so much whether there is trust, but how far it goes, where its limits are, and to what those are due. Fourth, a distinction should be made between reliance and trust, i.e. between control and trust that goes beyond control.

When formal institutions for the control of opportunity and incentive in the form of a reliable legal and judicial system (left upper corner of Table 1) are lacking in a country, people may take the option of grabbing hierarchical control, or carefully crafting a balance of mutual dependence in individual relationships, or taking hostages, e.g. in marriage relationships, or in blackmail with sensitive information, or in literally taking people hostage with a threat of death (right upper corner of Table 1). Alternatively, they can employ an ethic of proper conduct (left lower corner), if it exists, or build personalized relationships of empathy, identification and routinization (right lower corner). Finally, they can employ go-betweens, if available. The latter are mostly used to help in developing individual relationships, in both control by mutual dependence (upper right) and trust (lower right).

A problem in developing reliable relationships arises when uncertainty is so large as to limit the time horizon of relationships, which discourages specific investments needed for building up the relationship and developing empathy, as probably is the case in many developing countries. This yields a paradox. Especially in the absence of reliable formal institutions, more investment needs to be made in the building of reliability and trustworthiness in individual relationships, but since such investments are often highly specific, this will only be done if there is a sufficiently long term perspective for making such investment worth while, and precisely in underdeveloped countries uncertainty is often too large for that. It is not evident that intermediaries can always solve this problem. Also, in less developed countries they tend to be much less available, with lesser developed trade- and professional organizations, and a lesser developed commercial service sector. Then relationships may retreat into local bonding groups of family or clan.

In the left lower corner, if a nationwide ethic is lacking, people fall back on loyalty within smaller communities of tribes, clans, religious groups, (extended) families, or highly localized networks. The much reported importance of networks, clusters and industrial districts in Italy, and the phenomenon of the mafia, appear to be due to an institutional weakness, in an unreliable judiciary, that has historical roots in the 18th century, when in the kingdoms of Naples and Sicily the Spanish Habsburg emperor Carlos deliberately destroyed the institutional fabric of society in a strategy to forestall effective rebellion (Pagden 1988). This was cheaper and more effective than suppression by military force, as the emperor learned from his failure to contain rebellion in the Netherlands.

Alternatively, people can opt for relation-specific control (upper right corner), by the appropriation of political and economic power for hierarchical control, or by carefully balancing mutual dependence, or by taking hostages, literally or by blackmail with sensitive information.

A peaceful path may be found in a combination of balancing mutual dependence and building personal trust, in individual relationships, but the transaction costs involved are

high, the arrangement is generally fragile without some institutional back-up, the time horizon may be too short, and temptations and pressures may easily build up to revert to power grabbing, hostage taking and blackmail. Such power grabbing may next obstruct the development of formal institutions whose lack led to the grabbing of power.

The analysis may have implications for the effects of Putnam's (2000) bridging and bonding groups. Bridging different groups is supposed to have a more positive effect on economic performance, because it may loosen entrenched special interests of bonding groups (Olsen 1971), and may help to arrive at shared norms of conduct (lower left corner of Table 1). Also, bridging enables the utilization of diversity of knowledge that tends to enhance innovation. And indeed, when there is an institutional framework to facilitate bridging, such positive effect may be expected, relative to bonding groups. However, as noted by Knorringa and van Staveren (2005), when such institutional backing is lacking, people may have to fall back on bonding groups, for the reasons indicated above, and under those conditions matters would only be worse without them.

Conclusions

If social capital is associated with a set of largely informal relationships that can help to achieve goals, reliance is and trust may be both a condition and an outcome of it. The notion of trust is subject to much ambiguity and confusion. For measurement, in surveys, and analysis, and for cross-country comparisons, one should be aware of distinctions between objects of trust (people, firms, institutions), aspects of behaviour (competence, intentions), the limits of trust (due to pressures of survival), and the distinction between reliability, which includes control, and trustworthiness, which goes beyond control.

Reliability has a wide range of possible sources, in control and sources of trust, both within and outside relationships. This paper offers a tool to analyze the presence or absence of those sources, to arrive at a diagnosis of reliability, its limits and potential remedies. The analysis was used, in a tentative, indicative rather than systematic fashion, for some reflections on the conditions for reliance and trust in developing countries. As expected, in many developing countries most of the sources of reliability seem lacking, due to undeveloped institutions and markets, so that reliability is often reduced to trustworthiness on the basis of small, localized group cohesion and personalized relationships, which can be very fragile, yielding limited leverage for prosperity.

Development aid is problematic in a country where the basis for reliability falls short. In theory, there are several ways to repair gaps in reliability: improve formal institutions of control, such as laws and regulations, and the reliability of their enforcement; build a shared ethic of conduct, institute or support reliable go-betweens that help people to develop reliable relationships. In practice, of course, such measures are often very difficult to implement and take a long time. It is particularly difficult if a shared ethic is lacking due to ethnic, tribal and religious rivalry.

Perhaps the best, or most feasible, approach to development lies on the meso level, in the development of bridging and bonding capital, with go-betweens, as suggested by Knorringa and van Staveren (2005), to help individual people and small firms to develop reliable relationships beyond the limited scope of family, clan or local community.

Collaboration between firms and other organizations, including roles of third parties, and their control, in networks of firms, or *clusters* and *industrial districts*, as a function of their structure and strength of ties, is analyzed in a huge literature, in economics, regional development, geography and sociology, which cannot be discussed in the present paper but that is clearly relevant for development research, if it wants to systematically include the meso level.

Perhaps the most important lesson from the present analysis is that social capital and trust are highly systemic, with a strong complementarity between the various sources of reliability, in institutions and individual relationships, and, by consequence, between the lack of such sources. Lack of reliable regulatory institutions increases the need for building relation-specific reliability, but to do that beyond local communities of family or clan often requires specific investments that are made only if one can expect a relationship to last sufficiently long to make that worth while, and the uncertainty due to lack of institutions may also preclude that. In the absence of both reliable regulation and a basis for building reliable relationships, there is a temptation, or pressure, to survive by grabbing power, imposing hierarchy or taking hostages, which tends to reinforce the tribal or clan divisions that to a large extent caused the problems to begin with. An approach through building bridging capital will also run up against such problems. Yet, that remains the most likely approach.

In this paper, the analysis has been entirely theoretical. The framework of trust vs. control as different sources of reliance has been tested, in different ways, on the basis of surveys of buyer-supplier relationships (Berger et al. 1995, Nooteboom et al. 1997), and on the basis of longitudinal case studies (Klein Woolthuis et al. 2005). Relational signaling in the development of trust has been tested e.g. by Six (2005) and a categorization of corresponding trust building actions has been tested by Six and Nooteboom (2006). Nevertheless, claims for the present analysis have to be further tested, and its usefulness for development policy remains to be tested.

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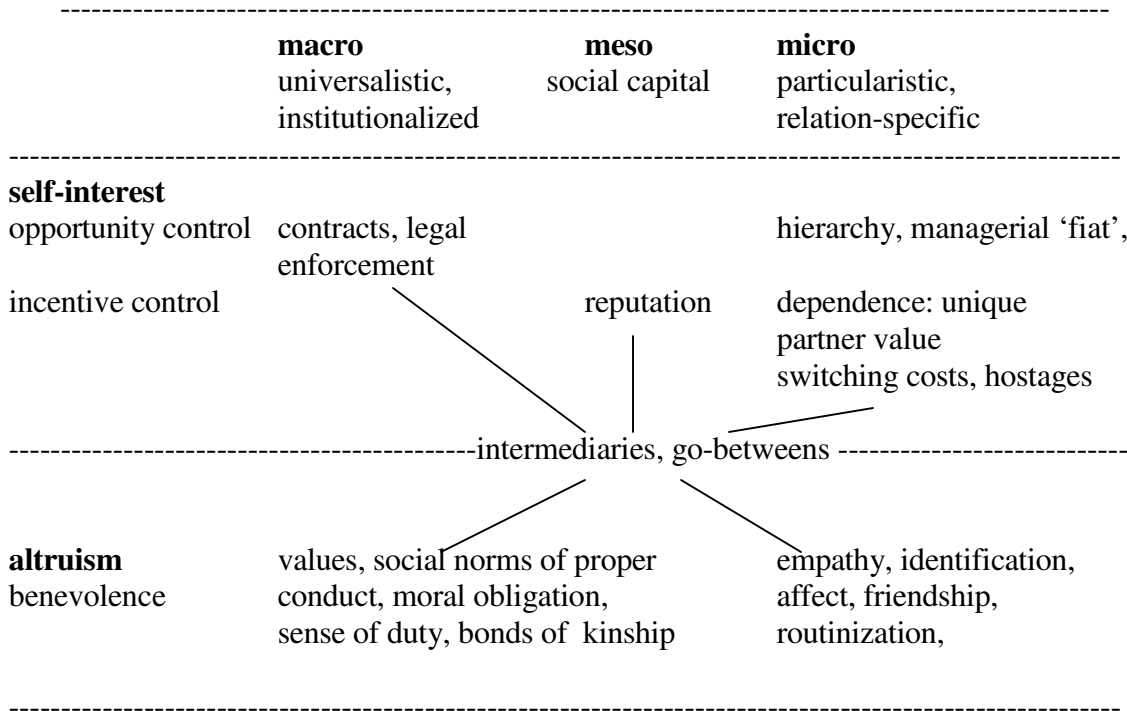
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Table 1 Sources of (intentional) reliability



source: adapted from Nooteboom (2002).